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## Internet Retailers and Intertype Competition: How the Supreme Court's Incomplete Analysis in *Leegin v. PSKS* Leaves Lower Courts Improperly Equipped to Consider Modern Resale Price Maintenance Agreements

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# **Internet Retailers and Intertype Competition: How the Supreme Court's Incomplete Analysis in *Leegin v. PSKS* Leaves Lower Courts Improperly Equipped to Consider Modern Resale Price Maintenance Agreements**

## **ABSTRACT**

*In Leegin Creative Leather Products, Inc. v. PSKS, Inc., the U.S. Supreme Court held that resale price maintenance (RPM) agreements are to be judged under the rule of reason. An RPM agreement is an agreement between a manufacturer and retailers stipulating that retailers will charge a certain price for the manufacturer's products. This Note argues that the Supreme Court should have instructed lower courts to consider intertype competition in addition to interbrand and intrabrand competition when evaluating RPM agreements under the rule of reason. Two reasons lead to this conclusion. First, the Internet has invigorated intertype competition and has made it an important competitive force in the economy. Resale price maintenance agreements have the potential to harm intertype competition; therefore, courts should consider intertype competition when applying the rule of reason. Second, the growth of online retailing has challenged the traditional rationales for RPM agreements. Online retailers may not react to an RPM agreement in the same way as traditional retailers, and the existence of online retailers now makes it more difficult for courts to determine whether an RPM agreement is necessary for a manufacturer to prevent free riding. If courts would consider intertype competition when applying the rule of reason, they would more accurately and fairly assess the competitive effects of these agreements.*

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In 2007 the U.S. Supreme Court overruled nearly a century of precedent and changed antitrust law dramatically when it issued its opinion in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*<sup>1</sup> The controversial five-to-four decision may affect many Internet retailers. *Leegin* held that courts must apply the rule of reason when evaluating resale price maintenance (RPM) agreements.<sup>2</sup> The effect of this holding is quite simple: manufacturers, in most instances, may now legally require retailers to charge manufacturer-suggested retail prices.<sup>3</sup> For nearly one hundred years prior to *Leegin*, RPM agreements and policies were illegal per se under Section 1 of the Sherman Act.<sup>4</sup>

Whether or not RPM agreements are legal is an important question to society in general—and to online retailers in particular—because these agreements can stifle online retailers' ability to compete in and enter new markets.<sup>5</sup> Internet retailers often compete against traditional, brick-and-mortar retailers by offering lower prices and providing different shopping experiences for consumers.<sup>6</sup> Competition

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1. 127 S. Ct. 2705 (2007).

2. *Id.* at 2725; see also Ashley Doty, Note, *Leegin v. PSKS: New Standard, New Challenges*, 23 BERKELEY TECH. L.J. 655 (2008) (thoroughly discussing *Leegin*).

3. See Richard A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 U. CHI. L. REV. 1, 14 (1977) ("[I]n practice, [the rule of reason] is little more than a euphemism for nonliability.").

4. *Leegin*, 127 S. Ct. at 2725 (Breyer, J., dissenting); see also Note, *Leegin's Unexplored "Change in Circumstance": The Internet and Resale Price Maintenance*, 121 HARV. L. REV. 1600 (2008) (providing an excellent discussion of *Leegin* vis-à-vis the Internet).

5. See LAWRENCE A. SULLIVAN & WARREN S. GRIMES, *THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK* 289-90, 302-03, 317-27 (2000).

6. See Mary Wolfenbarger & Mary C. Gilly, *Shopping Online for Freedom, Control and Fun*, 43-2 CAL. MGMT. REV. 34, 34-36 (describing how consumers' goals and experiences shopping online will affect the amount that they choose to spend online or in other environments); see also Erich M. Fabricius, Recent Development, *The Death of Discount Online Retailing? Resale Price Maintenance After Leegin v. PSKS*, 9 N.C. J.L. & TECH. 87 (2007) (providing an informative discussion of *Leegin* and noting the growth of online retailing in recent years).

among different types of retailers selling similar products is known as intertype competition.<sup>7</sup>

Other unique types of firms such as mail-order-catalog firms and factory-outlet stores generate intertype competition as well, but the Internet has done much more to make intertype competition a robust competitive force.<sup>8</sup> Online sales have grown at a rate of 25 percent over the last 5 years, and reached over 100 billion dollars in 2006.<sup>9</sup> Internet retailers often challenge brick-and-mortar firms by charging lower prices.<sup>10</sup> They also challenge traditional firms by providing consumers with the ability to browse products and make purchases from home, which is often more convenient for consumers.<sup>11</sup>

In *Leegin*, the Supreme Court held that the rule of reason applies to RPM agreements, effectively legalizing these agreements in many, if not most, cases.<sup>12</sup> The rule of reason is a case-by-case analytical approach that requires courts to examine a number of factors in order to determine whether a challenged business practice violates the Sherman Act.<sup>13</sup> After *Leegin*, when applying the rule of reason to RPM agreements, courts will now generally look to whether the agreement was put in place to encourage retailers to provide adequate point-of-sale services or to prevent free riding.<sup>14</sup> The *Leegin* Court argued that RPM can often be beneficial for these very reasons.<sup>15</sup>

These traditional justifications for RPM agreements—that they induce retailers to provide point-of-sale services and eliminate free riding—focus on both interbrand and intrabrand competition.<sup>16</sup>

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7. Chip E. Miller, James Reardon & Denny E. McCorkle, *The Effects of Competition on Retail Structure: An Examination of Intratype, Intertype, and Intercategory Competition*, 63 J. MARKETING 107, 107 (1999).

8. See *infra* text accompanying notes 135-59 (demonstrating that the Internet has invigorated intertype competition).

9. U.S. CENSUS BUREAU, E-STATS 3 (2008), available at <http://www.census.gov/eos/www/2006/2006reportfinal.pdf>.

10. See Note, *supra* note 4, at 1613-15 (noting that prices at purely online retailers tend to be lower than Internet prices available at retailer using both online and traditional retail formats). At least one study has found that 26.4% of consumers visited brick-and-mortar stores before completing their online purchase. *Id.* at 1616.

11. See Wolfenbarger & Gilly, *supra* note 6, at 42-43.

12. *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2724 (2007); see also Posner, *supra* note 3, at 14 (explaining that the rule of reason is a euphemism for legality).

13. *Leegin*, 127 S. Ct. at 2726 (Breyer, J., dissenting) (describing the rule of reason).

14. See *Leegin*, 127 S. Ct. at 2715-16 (discussing how resale price maintenance can be used in ways that do not threaten competition and may indeed be good for competition).

15. *Id.*

16. *Id.* at 2715 (explaining resale price maintenance in terms of interbrand and intrabrand competition).

Interbrand competition is competition among different brands, while intrabrand competition is competition between different entities selling the same brand.<sup>17</sup> In *Leegin*, the Court found that RPM increases interbrand competition, and therefore makes markets more competitive generally.<sup>18</sup> The Court, however, did not give adequate consideration to the way in which RPM agreements can reduce competition by negatively impacting intertype competition.<sup>19</sup> Moreover, the traditional justifications for RPM—which center conceptually on interbrand and intrabrand competition<sup>20</sup>—do not adequately capture changes in the marketplace brought about by the Internet.<sup>21</sup>

This Note argues that the Supreme Court should have instructed lower courts to also consider intertype competition when applying the rule of reason to RPM agreements. Courts should consider the effect that an RPM agreement has on intertype competition because these agreements can often harm intertype competition, which may lead to less competition generally. By considering intertype competition along with interbrand and intrabrand competition, courts will be able to more accurately evaluate RPM agreements in light of marketplace changes created by Internet commerce.

Section I provides background information on RPM agreements and a brief overview of the Supreme Court's treatment of RPM from its 1911 decision in *Dr. Miles Medical Co. v. John Park and Sons Co.*<sup>22</sup> to its *Leegin* decision in 2007. Section II discusses intertype competition, explaining how the Internet has made it more important, and argues that the Supreme Court should have instructed lower courts to consider intertype competition when evaluating RPM agreements under the rule of reason. Section III concludes the Note with a summary of the argument.

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17. ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY 340-41 (2002).

18. *Leegin*, 127 S. Ct. at 2715.

19. See *infra* text accompanying notes 160-69.

20. See GAVIL, KOVACIC & BAKER, *supra* note 17, at 340-42 (explaining the difference between “interbrand” and “intrabrand” competition).

21. See *infra* text accompanying notes 199-208 (arguing that intertype competition along with interbrand and intrabrand competition more accurately describe the marketplace).

22. 220 U.S. 373, 407-09 (1911).

## I. BACKGROUND

### *A. Resale Price Maintenance Agreements and Their Underlying Policies*

Resale price maintenance is a type of vertical-distribution restraint.<sup>23</sup> A vertical restraint involves entities at different levels in a supply chain, such as manufacturers and retailers, as opposed to a horizontal restraint, which involves competitors at the same level, such as different retailers.<sup>24</sup> Resale price maintenance is a practice in which upstream distributors (often manufacturers) enter into agreements with downstream dealers (often retailers) that specify prices at which products must be sold.<sup>25</sup> Common reasons why manufacturers might want to implement an RPM policy include the desire to encourage retailers to offer high-quality point-of-sale services, such as a friendly and knowledgeable sales staff, nice showrooms, or better warranties.<sup>26</sup> Manufacturers also might want to use RPM policies to prevent free riding or to promote a high-end brand image.<sup>27</sup>

### *B. Rule of Reason and Per Se Illegality*

In 1890 Congress passed the federal antitrust statute popularly known as the Sherman Act. Section 1 of the Sherman Act imposes civil and criminal liability on every person making a “contract, combination . . . or conspiracy, in restraint of trade.”<sup>28</sup> The Supreme Court developed two general rules for determining whether a business practice violates Section 1 of the Sherman Act: the per se rule and the rule of reason.<sup>29</sup> The circumstances in which courts apply the rule of

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23. GAVIL, KOVACIC & BAKER, *supra* note 17, at 340.

24. *Id.*

25. *Id.* at 374 (“If minimum resale price maintenance is permitted, the manufacturer may write a contract with the retailer that sets the price at which the retailer re-sells its [merchandise] to consumers.”).

26. *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2715-17 (2007).

27. *Id.*

28. 15 U.S.C. § 1 (2007).

29. *Leegin*, 127 S. Ct. at 2712-13, 2720 (discussing the per se rule and rule of reason in the context of vertical restraints); *see also* SULLIVAN & GRIMES, *supra* note 5, at 167 (providing background information on the per se rule and rule of reason).

reason and the per se rule have changed since the time that the Sherman Act was enacted.<sup>30</sup>

### 1. Rule of Reason

The rule of reason is a circumstance-specific, case-by-case approach to determining whether a business practice is an unreasonable restraint on trade and thus violates the Sherman Act.<sup>31</sup> The rule of reason is the prevailing standard by which business practices are judged.<sup>32</sup> In applying the rule of reason, courts weigh a number of factors “including specific information about the . . . business’ and ‘the restraint’s history, nature, and effect.’”<sup>33</sup> A classic formulation of the rule of reason was set forth in *Board of Trade of Chicago v. United States*:

The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.<sup>34</sup>

The rule of reason has been criticized for being too vague, leaving courts and society with little guidance for determining when business practices adjudicated under the rule of reason will be deemed illegal.<sup>35</sup> It is often expensive and difficult for plaintiffs to prove violations of the rule of reason, which has led some commentators to conclude that

30. SULLIVAN & GRIMES, *supra* note 5, at 167-68. Compare *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 407-09 (1911) (holding resale price maintenance agreements are illegal), and *Leegin*, 127 S. Ct. at 2709-10 (overruling *Dr. Miles* and holding that resale price maintenance agreements are judged under the rule of reason), with *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 381-82 (1967) (holding that intrabrand, non-price restraints are per se illegal) and *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 57-59 (1977) (overruling *Arnold* and holding that intrabrand non-price restraints are judged under the rule of reason).

31. *Bd. of Trade of Chi. v. United States*, 246 U.S. 231, 238 (1918) (stating that courts applying the rule of reason should “consider the facts peculiar to the business to which the restraint is applied”).

32. *Leegin*, 127 S. Ct. at 2712 (“The rule of reason is the accepted standard for testing whether a practice restrains trade in violation of [the Sherman Act].”).

33. *Id.* (quoting *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997)).

34. 246 U.S. at 238.

35. Posner, *supra* note 3, at 14 (“The content of the rule of reason is largely unknown; in practice, it is little more than a euphemism for nonliability.”); Note, *supra* note 4, at 1620 (explaining how the rule of reason is unpredictable, which is particularly problematic for businesses who must rely on this rule).



business practices that are judged under the rule of reason are essentially legal.<sup>36</sup>

## 2. Per Se Rule

In contrast to the rule of reason, some business practices have been found to be so harmful to competition that they warrant per se condemnation under the Sherman Act.<sup>37</sup> For example, the Supreme Court has held that horizontal agreements among competitors to fix prices, such as cartel agreements, are per se illegal under the Sherman Act.<sup>38</sup> When courts apply the per se rule, they do not examine if the business practice may be beneficial in some way; instead, they simply condemn the practice as a violation of the antitrust laws.<sup>39</sup>

### *C. Dr. Miles Holds that Resale Price Maintenance Agreements Are Per Se Illegal*

In 1911 the Supreme Court, in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, addressed whether a manufacturer could impose an RPM policy on retailers and wholesalers that sold its products.<sup>40</sup> The plaintiff company, Dr. Miles, sold "proprietary medicines, prepared by means of secret methods and formulas,"<sup>41</sup> and specified prices at which retailers and wholesalers were required to sell its products.<sup>42</sup> Upon learning that a wholesaler had refused to adhere to its pricing policy, Dr. Miles sued, claiming that that by selling its products using a "cutrate" or "cut-price system," the wholesaler had damaged the company's reputation.<sup>43</sup>

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36. Note, *supra* note 4, at 1620 (explaining that in the resale price maintenance context the rule of reason amounts to per se legality and that few private plaintiffs bring suit under this rule because of the high cost).

37. SULLIVAN & GRIMES, *supra* note 5, at 167-68.

38. GAVIL, KOVACIC & BAKER, *supra* note 17, at 95 (explaining that once price fixing is found, a per se rule applies); SULLIVAN & GRIMES, *supra* note 5, at 168 (noting that naked price fixing among competitors remains per se illegal).

39. GAVIL, KOVACIC & BAKER, *supra* note 17, at 95-96 (explaining that the per se rule precludes all attempts to demonstrate "reasonableness").

40. 220 U.S. 373, 374-75 (1911).

41. *Id.* at 374. Dr. Miles produced products such as "Dr. Miles' Nervine," a tonic for treating nervous disorders such as "sleeplessness, hysteria, headache, neuralgia, backache, pain, epilepsy, spasms, fits, and St. Vitus' dance," as well as Alka-Seltzer. *Id.* In 1979 Dr. Miles was bought out by Bayer AG. *Id.*

42. *Dr. Miles*, 220 U.S. at 374.

43. *Id.* at 374-75.

The Supreme Court held that the RPM agreement that Dr. Miles sought to enforce was unlawful for two reasons. First, the Court held that such agreements were unenforceable as a matter of property law based on the ancient common-law doctrine of restraints on alienation.<sup>44</sup> Thus, the Court concluded that RPM agreements were not only unenforceable but also illegal.<sup>45</sup> Furthermore, underlying the Court's analysis was the belief that RPM agreements were equivalent to agreements among competitors to fix prices,<sup>46</sup> and constituted a practice that clearly harmed competition.<sup>47</sup> It was this second rationale that the Court would later focus on and reject in *Leegin*.<sup>48</sup>

Although the Court in *Dr. Miles* did not explicitly state that RPM agreements were per se illegal under the Sherman Act, courts and commentators after *Dr. Miles* interpreted the opinion to mean just that.<sup>49</sup> Notably absent from the Court's opinion was any serious consideration of the procompetitive and anticompetitive effects of RPM agreements.<sup>50</sup>

#### *D. The Supreme Court's Approach to Vertical Restraints Ebbs and Flows*

Between the 1940s and 1970s, application of the per se rule characterized the Supreme Court's approach to analyzing the legality of vertical agreements under the Sherman Act.<sup>51</sup> By 1967 most vertical agreements regarding price and non-price competition were determined to be per se illegal.<sup>52</sup> However, in 1977 the Court's philosophy toward antitrust law began to change, and its approach to vertical restraints ebbed away from the per se rule and toward the

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44. *Id.* at 404-05; *see also* *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2714 (2007) ("By relying on the common-law rule against restraints on alienation, the [*Dr. Miles*] Court justified its decision based on 'formalistic' legal doctrine . . . .") (citations omitted)).

45. *Dr. Miles*, 220 U.S. at 408-09.

46. *Id.*

47. *Id.*; *see also* SULLIVAN & GRIMES, *supra* note 5, at 168-69 (discussing how cartel agreements, among other things, reduce output, transfer wealth from consumers to the cartel, dampen entry opportunities, and discourage innovation).

48. *Leegin*, 127 S. Ct. at 2714 (noting that later courts rejected the assumption made by the *Dr. Miles* Court that vertical agreements had the same negative effect on competition as horizontal agreements among competitors).

49. *Id.* at 2713. ("The Court has interpreted *Dr. Miles* as establishing a per se rule against [resale price maintenance agreements]." (emphasis in original) (citations omitted)).

50. *Compare Dr. Miles*, 220 U.S. at 408-09, *with* *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 51-58 (1977).

51. GAVIL, KOVACIC & BAKER, *supra* note 17, at 350.

52. *Id.*

rule of reason.<sup>53</sup> That year, in *Continental T.V., Inc. v. GTE Sylvania Inc.*, the Court held that the rule of reason applied to a manufacturer's attempt to geographically restrict where retailers sold its products.<sup>54</sup>

In *Sylvania*, a television-set manufacturer had a policy of limiting the geographic territories in which its franchisees could sell its products.<sup>55</sup> The manufacturer's goal was to attract "more aggressive and competent retailers" by insulating the retailers from competition among themselves.<sup>56</sup> The *Sylvania* Court declared that a "departure from the rule of reason" must be based on "demonstrable economic effect."<sup>57</sup> It concluded that the geographical restrictions imposed by the manufacturer benefited competition by encouraging retailers to "engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of [the manufacturer's] products."<sup>58</sup> The Court found that territorial restrictions actually increased interbrand competition, as retailers would begin competing based on non-price attributes that would make the manufacturer's brand more competitive as to other brands.<sup>59</sup>

In many respects, the territorial restraints at issue in *Sylvania* were similar to RPM agreements; however, *Sylvania* did not overrule *Dr. Miles*.<sup>60</sup> The Court justified its decision not to reconsider the legality of RPM agreements in a footnote, simply stating that "[t]he per se illegality of price restrictions has been established firmly for many years and involves significantly different questions of analysis and policy."<sup>61</sup> Justice White noted in his concurring opinion that the majority's emphasis on analyzing demonstrated economic effects made it hard to justify a continuing belief in the per se illegality of RPM under *Dr. Miles*.<sup>62</sup> Justice White pointed out that the procompetitive effects by which the majority justified applying the rule of reason in *Sylvania* would likely apply to RPM agreements.<sup>63</sup> Consequently, he argued, "[t]he effect, if not the intention, of the Court's opinion is necessarily to call into question the firmly established per se rule against price restraints" established by *Dr. Miles*.<sup>64</sup>

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53. SULLIVAN & GRIMES, *supra* note 5, at 319.

54. 433 U.S. 36, 38-39, 59 (1977).

55. *Id.* at 38-39.

56. *Id.* at 38.

57. *Id.* at 58-59.

58. *Id.* at 55.

59. *Id.*

60. *See id.* at 52 n.18.

61. *Id.*

62. *Id.* at 69-70 (White, J., concurring).

63. *Id.*

64. *Id.* at 70.

*Sylvania* ushered in a new era of antitrust jurisprudence as the Supreme Court began to embrace the Chicago school of economics' vision of antitrust law.<sup>65</sup> The Chicago school emphasizes the power of free markets to reach outcomes that maximize consumer welfare.<sup>66</sup> It advocates regulation only when necessary to prevent businesses from restraining trade in ways that reduce output and raise prices.<sup>67</sup>

*Sylvania* made clear that the principal goal of antitrust law is to promote and preserve economically efficient business practices.<sup>68</sup> Doctrinally, the decision positioned the rule of reason as the Sherman Act's "guiding force."<sup>69</sup> After *Sylvania*, the Court systematically overruled many of its precedents that had applied the per se rule, relying on economic theory in its interpretation and application of the Sherman Act.<sup>70</sup>

### *E. The Traditional Economic Justifications For and Against Resale Price Maintenance*

Resale price maintenance agreements have the potential to benefit or harm competition depending on the circumstances in which they are employed.<sup>71</sup> It was not until years after *Dr. Miles* was decided, however, that economists, scholars, and judges fully accepted the procompetitive rationales for RPM.<sup>72</sup>

65. Lino A. Graglia, *Leegin Creative Leather Products, Inc. v. PSKS, Inc.: The Strange Career of the Law of Resale Price Maintenance* 20-22 (U. Tex. Sch. L. L. & Econ. Research, Research Paper No. 115, 2007).

66. *Id.* at 22.

67. *Id.*

68. GAVIL, KOVACIC & BAKER, *supra* note 17, at 358; *see Sylvania*, 433 U.S. at 58-59.

69. GAVIL, KOVACIC & BAKER, *supra* note 17, at 358; *see Sylvania*, 433 U.S. at 58-59 ("departure from the rule-of-reason standard must be based upon demonstrable economic effect...").

70. GAVIL, KOVACIC & BAKER, *supra* note 17, at 358; *see, e.g., State Oil Co. v. Khan*, 522 U.S. 3, 22 (1997) (holding that *maximum* resale price maintenance is to be judged under the rule of reason).

71. *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2715-17 (2007) (discussing how resale price maintenance can create procompetitive and anticompetitive effects depending on the circumstances); *see generally* HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE* 442-56 (2d ed. 1999) [hereinafter HOVENKAMP, *FEDERAL ANTITRUST*].

72. *See* Posner, *supra* note 3, at 3-4. Judge Posner pointed out that by the time *Sylvania* was decided, the prevailing view of vertical restraints had changed and courts were more willing to accept the procompetitive rationales used to justify resale price maintenance. *Id.*

### 1. Possible Procompetitive Effects

Resale price maintenance agreements limit competition among a manufacturer's retailers (intrabrand competition) but increase competition among brands (interbrand competition).<sup>73</sup>

#### *a. Resale Price Maintenance Policies Can Induce Retailers To Provide the Services and Amenities that Customers Value*

Manufacturers can use RPM policies to induce retailers to provide point-of-sale services that consumers value.<sup>74</sup> This practice, in theory, increases interbrand competition.<sup>75</sup> When a manufacturer imposes an RPM agreement, it eliminates price competition among its retailers.<sup>76</sup> In order to attract customers, retailers will compete with one another by seeking to provide superior point-of-sale services, such as better showrooms or warranties.<sup>77</sup>

Assuming that consumers value these additional point-of-sale services, consumers will demand more of the product, and the demand curve will shift upward.<sup>78</sup> This increase in demand offsets what would otherwise be a reduction in sales as a result of the uniformly higher, manufacturer-mandated price of the product.<sup>79</sup> In this scenario, the amount that a retailer will invest to provide point-of-sale services equals the difference between the retailer's marginal cost and the price under the RPM agreement.<sup>80</sup> Manufacturers benefit from the RPM policy because demand for their products increases and the point-of-sale services make their brands more competitive with other brands.<sup>81</sup> Resale price maintenance, therefore, increases interbrand competition by making a manufacturer's brand more competitive in relation to other brands.<sup>82</sup>

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73. *Leegin*, 127 S. Ct. at 2715 (noting that minimum resale price agreements can increase interbrand competition by reducing intrabrand competition).

74. *Id.* at 2715-16; STEVEN E. LANDSBURG, PRICE THEORY & APPLICATIONS 380-84 (6th ed. 2005).

75. See LANDSBURG, *supra* note 74, at 381.

76. *Id.*; see also *Leegin*, 127 S. Ct. at 2716 ("With price competition decreased, the manufacturer's retailers compete among themselves over services.").

77. See LANDSBURG, *supra* note 74, at 381.

78. *Id.*

79. *Id.*; see *Leegin*, 127 S. Ct. at 2715 (discussing how resale price maintenance increases interbrand competition).

80. LANDSBURG, *supra* note 74, at 381 exhibit 11.4 (illustrating and explaining the cost that retailers will incur to provide point-of-sale services).

81. See *id.*; see also HOVENKAMP, FEDERAL ANTITRUST, *supra* note 71, at 455-56 (providing a more detailed discussion of this principle).

82. *Leegin*, 127 S. Ct. at 2715-16.

*b. Resale Price Maintenance Policies Can Prevent Free Riding*

Resale price maintenance agreements can also induce retailers to offer more point-of-sale services by eliminating free riding.<sup>83</sup> Free riding occurs when customers visit a retailer with a nice showroom and friendly sales staff in order to learn about a product, but then go to a no-frills retailer to make a purchase at a lower price.<sup>84</sup> Because of this consumer behavior, retailers may be deterred from investing enough in point-of-sale services out of fear that their rivals will free ride off of their superior services.<sup>85</sup> If point-of-sale services are not offered, however, the overall demand for the manufacturer's product may decrease.<sup>86</sup> In such cases, manufacturers will want to eliminate free riding and can use RPM agreements to ensure that free riding does not discourage retailers from providing the necessary point-of-sale services that many customers desire.<sup>87</sup>

2. Possible Anticompetitive Effects of Resale Price Maintenance

Depending on the circumstances, RPM agreements can be used in anticompetitive ways. Manufacturers or retailers can use RPM agreements, in some circumstances, to organize and police cartel agreements.<sup>88</sup> In addition, a dominant retailer could use an RPM policy to forestall innovation in the distribution channel.<sup>89</sup>

*a. Resale Price Maintenance May Be Used to Enforce Manufacturer or Retailer Cartel Agreements*

Both manufacturers and retailers can use RPM agreements to police a cartel agreement.<sup>90</sup> In a situation where retailers have agreed to fix prices, they could coerce a manufacturer into implementing such

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83. HOVENKAMP, FEDERAL ANTITRUST, *supra* note 71, at 450-53; *see also* LANDSBURG, *supra* note 74, at 380-81 (providing a hypothetical explanation of the free-rider problem).

84. LANDSBURG, *supra* note 74, at 380 (explaining free riding in the context of consumer electronics); *see also* HOVENKAMP, FEDERAL ANTITRUST, *supra* note 71, at 450-53 (explaining free riding).

85. HOVENKAMP, FEDERAL ANTITRUST, *supra* note 71, at 450; LANDSBURG, *supra* note 74, at 380-81.

86. HOVENKAMP, FEDERAL ANTITRUST, *supra* note 71, at 450.

87. *Id.* at 450-53.

88. *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2717-18 (2007); HOVENKAMP, FEDERAL ANTITRUST, *supra* note 71, at 443-48.

89. *Leegin*, 127 S. Ct. at 2717; HOVENKAMP, FEDERAL ANTITRUST, *supra* note 71, at 448.

90. HOVENKAMP, FEDERAL ANTITRUST, *supra* note 71, at 443-48.

an agreement in order to ensure that all retailers are adhering to the cartel's price.<sup>91</sup> Manufacturers, however, do not benefit from retailer cartels, and would have an incentive to resist imposing a resale price agreement in order to help support such a cartel.<sup>92</sup> Moreover, retailer markup is, in essence, the cost a manufacturer pays to have its products distributed; naturally, a manufacturer wants to keep this cost as low as possible.<sup>93</sup>

In some instances, manufacturers could use an RPM agreement to shore up a manufacturer's cartel.<sup>94</sup> Manufacturers could use this type of agreement to monitor prices at the retail level to ensure that no member of the cartel cheats on the agreement.<sup>95</sup> Regardless of whether the RPM agreement is being used to support a retailer or manufacturer cartel, a sufficient number of manufacturers would have to be involved in order for it to be profitable; otherwise consumers would switch to lower-priced brands.<sup>96</sup>

*b. Resale Price Maintenance May Be Used By a Dominant Retailer to Forestall Innovation in the Distribution Channel*

Resale price maintenance agreements may also be used when a large retailer seeks to preserve its lion's share of the market by forestalling innovation in the distribution channel.<sup>97</sup> A dominant retailer may use its buying power to coerce a manufacturer into imposing an RPM policy in order to prevent firms who have lower costs from entering the market and undercutting its prices.<sup>98</sup> In such cases, the dominant retailer may not only restrain competition by lower-cost firms, but it may also forestall innovation in the distribution channel because firms will not have an incentive to design innovative business models that allow them to offer a lower price.<sup>99</sup> For instance, firms like online retailers that generally have lower costs may be deterred from entering the market if they know they

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91. *Id.* at 445-47.

92. *Leegin*, 127 S. Ct. at 2718-19 (explaining how the interests of manufacturers and consumers are generally aligned with respect to retailer profit margins).

93. *Id.* at 2718.

94. *Id.* at 2717; HOVENKAMP, FEDERAL ANTITRUST, *supra* note 71, at 447-48.

95. HOVENKAMP, FEDERAL ANTITRUST, *supra* note 71, at 447-48.

96. *Id.*; *see Leegin*, 127 S. Ct. at 2717, 2719.

97. *Leegin*, 127 S. Ct. at 2717, 2719.

98. *Id.*

99. *See id.*

cannot gain market share by undercutting the incumbent firm's price.<sup>100</sup>

*F. The Supreme Court's Decision in Leegin Creative Leather Products, Inc. v. PSKS, Inc.*

Leegin Creative Leather Products designed, distributed, and manufactured leather products, including women's belts and accessories.<sup>101</sup> It did so under the Brighton brand name.<sup>102</sup> In 1997 Leegin instituted two promotion policies under which it refused to sell its products to retailers who failed to adhere to the suggested retail prices—in essence, this was an RPM policy.<sup>103</sup> Leegin hoped this would incentivize smaller retailers—which Leegin believed provided better service—to carry its products since it thought that large department stores like Macy's, Bloomingdales, and May Co. did not provide, adequate services and product support.<sup>104</sup>

Kay's Kloset was a retailer who sold Leegin's products and who participated in its RPM program.<sup>105</sup> Leegin learned, however, that Kay's had been marking down Brighton's entire product line by 20 percent.<sup>106</sup> (Leegin also came to believe that Kay's stores were not attractive enough.)<sup>107</sup> Leegin requested Kay's to stop marking down Brighton products, but Kay's refused.<sup>108</sup> After Leegin stopped selling Brighton products to Kay's, Kay's sued in the United States District Court for the Eastern District of Texas, alleging that Leegin violated the antitrust laws by entering into RPM agreements with its retailers.<sup>109</sup> The district court found that the per se rule applied and entered a judgment in Kay's favor.<sup>110</sup> The Fifth Circuit affirmed.<sup>111</sup>

The Supreme Court granted certiorari to determine whether RPM agreements should continue to be treated as per se unlawful or

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100. *Id.* at 2733 (Breyer, J., dissenting) (stating that resale price maintenance can make "it more difficult for price-cutting competitors (perhaps Internet retailers) to obtain market share"); see Fabricius, *supra* note 6, at 103 (noting how online retailers may have lower overhead costs and greater efficiency).

101. *Leegin*, 127 S. Ct. at 2710.

102. *Id.*

103. *Id.* at 2711.

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.* at 2712.

110. *Id.*

111. *Id.*



should be judged under the rule of reason.<sup>112</sup> Writing for the majority, Justice Kennedy reiterated *Sylvania's* holding that the rule of reason is the accepted standard for testing whether a practice restrains trade in violation of the Sherman Act.<sup>113</sup> He explained that *Dr. Miles* was based on faulty reasoning because of its unfounded reliance on property law as well as its mistaken assumption that vertical agreements between manufacturers and retailers are analogous to a horizontal agreement between competitors.<sup>114</sup> Justice Kennedy explained that cases since *Dr. Miles* had called into question whether RPM agreements should remain per se illegal.<sup>115</sup> Under these cases, practices that restrained trade could only be held per se illegal if they "would always or almost always tend to restrict competition and decrease output."<sup>116</sup> To justify a per se rule, Justice Kennedy wrote that a restraint must have "manifestly anticompetitive" effects.<sup>117</sup>

In its opinion, the Court explained how manufacturers can use RPM to induce retailers to provide optimal point-of-sale services and reduce free riding.<sup>118</sup> It also noted that RPM can stimulate interbrand competition by reducing intrabrand competition.<sup>119</sup> It stated that "[a] single manufacturer's use of [an RPM policy] tends to eliminate intrabrand price competition; this in turn encourages retailers to invest in tangible or intangible services or promotional efforts that aid the manufacturer's position as against rival manufacturers."<sup>120</sup>

The Court also discussed how RPM can produce anticompetitive effects.<sup>121</sup> In particular, the Court explained how RPM agreements may be used by a manufacturer or retailer cartel, and how a dominant retailer may use those agreements to forestall innovation in the distribution channel.<sup>122</sup> The Court suggested that several factors are relevant when applying the rule of reason to RPM policies.<sup>123</sup> Specifically, the Court noted that the number of

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112. *Id.*

113. *Id.*

114. *Id.* at 2714.

115. *Id.*

116. *Id.* at 2713 (quoting *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988)).

117. *Id.* (quoting *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 43 U.S. 36, 50 (1977)).

118. *Id.* at 2715-17.

119. *Id.* at 2715.

120. *Id.*

121. *Id.* at 2717.

122. *Id.* at 2716-17 (explaining how a dominant retailer could use resale price maintenance to forestall competition by making it hard for lower priced rivals to gain market share).

123. *Id.* at 2719.

manufacturers implementing these policies is relevant to an analysis of whether a particular agreement is illegal because this may help courts determine whether an RPM policy is being used to support a manufacturer or retailer cartel.<sup>124</sup> The Court also emphasized the importance of determining whether a retailer or manufacturer imposed the policy.<sup>125</sup> According to Justice Kennedy, there is more reason to be suspect of an RPM agreement if a retailer wanted it in effect.<sup>126</sup> Lastly, the Court stated that market power of the proponent of the agreement is a relevant concern, because without market power it is unlikely that an RPM policy could be used by either a manufacturer or retailer for anticompetitive purposes.<sup>127</sup>

The primary argument against overruling *Dr. Miles*, and the most salient argument raised by Justice Breyer in the dissent, was that *Dr. Miles* should remain good law because of the judicial principle of stare decisis.<sup>128</sup> However, the majority argued that stare-decisis concerns were not as significant in antitrust cases because the Court has traditionally treated the Sherman Act as a common-law statute, and “[j]ust as the common law adapts to modern understanding and greater experience, so too does the Sherman Act’s prohibitions on ‘restraint[s] of trade’ evolve to meet the dynamics of present economic conditions.”<sup>129</sup>

In unequivocal language, the Supreme Court overruled *Dr. Miles* and held that RPM agreements were no longer per se illegal but would be judged under the rule of reason.<sup>130</sup> Importantly, the Court did not specify how the rule of reason should apply in cases of RPM agreements, instead stating that “[a]s courts gain experience considering the effects of [RPM agreements] by applying the rule of reason over the course of decisions, they can establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses.”<sup>131</sup>

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124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.* at 2719-20.

128. *Id.* at 2731 (Breyer, J., dissenting) (stating that “untold numbers of business decisions” had been made in reliance on *Dr. Miles*).

129. *Id.* at 2720.

130. *Id.* at 2725.

131. *Id.* at 2720.

## II. A BETTER APPROACH: WHY COURTS SHOULD CONSIDER INTERTYPE COMPETITION WHEN APPLYING THE RULE OF REASON TO MINIMUM RESALE PRICE MAINTENANCE AGREEMENTS

The Supreme Court was correct to overrule *Dr. Miles* and hold that the rule of reason should apply to RPM agreements because in many circumstances such agreements can produce procompetitive effects. However, the Court should have instructed lower courts to consider intertype competition when applying the rule of reason to these agreements. Courts applying the rule of reason will likely only consider how an RPM agreement affects interbrand and intrabrand competition.<sup>132</sup> These definitions, however, fail to adequately account for competition between different types of firms competing in different distribution channels.

The Supreme Court should have instructed lower courts to also consider intertype competition as a factor when evaluating RPM agreements under the rule of reason for two specific reasons. First, the Internet has invigorated intertype competition, making it a more robust competitive force. Resale price maintenance agreements have the potential to hinder intertype competition. Second, assumptions about how firms behave in response to these agreements do not always apply when online retailers exist in the market place. The presence of online retailers makes it harder to determine, using the traditional justifications for RPM agreements, whether a particular agreement is detrimental to competition. Moreover, the terms "interbrand" and "intrabrand" fail to describe changes in the marketplace brought about by the Internet. By also considering intertype competition, courts will more accurately be able to assess the competitive impact of RPM agreements.

## III. THE SUPREME COURT SHOULD HAVE INSTRUCTED LOWER COURTS TO CONSIDER INTERTYPE COMPETITION

Intertype competition is competition that is created by the presence of different types of firms in the marketplace.<sup>133</sup> "For example, over the past century, each of the following retailing methods has flourished, in some cases only to be supplanted by more

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132. See *id.* at 2715 ("The justifications for vertical price restraints are similar to those for other vertical restraints. Minimum resale price maintenance can stimulate interbrand competition . . . by reducing intrabrand competition . . ."). The Court also listed several other factors that courts should consider when applying the rule of reason to resale price maintenance agreements. *Id.* at 2719.

133. Miller, Reardon & McCorkle, *supra* note 7, at 107.

efficient methods: the department store, mail order catalogues . . . , the specialty boutique, the drive-in, the supermarket, the specialty discount store, the warehouse discount store”—and now the online retailer.<sup>134</sup>

### *A. The Internet has Invigorated Intertype Competition*

The Internet has changed the business environment by making it possible for an entirely new type of retailer—the Internet retailer—to enter the market and compete with traditional retailers.<sup>135</sup> Retail sales online have grown at a precipitous rate, increasing by more than 25 percent from 2001 to 2006.<sup>136</sup> In comparison, over the same period, total retail sales increased by only 4.8 percent.<sup>137</sup> In 2006 e-commerce accounted for upwards of \$107 billion in the United States.<sup>138</sup> The Internet invigorates intertype competition by increasing price competition,<sup>139</sup> easing access to goods and services,<sup>140</sup> and providing consumers with a unique shopping experience and an alternative means to purchase products.<sup>141</sup>

The Internet often increases price competition among firms because in many instances prices online are lower than prices at traditional retailers.<sup>142</sup> Prices may be lower online because Internet retailers often have lower total costs.<sup>143</sup> Moreover, online retailers' costs are largely fixed as opposed to variable.<sup>144</sup> The Internet also makes it easier for firms to enter markets since Internet retailers can

134. SULLIVAN & GRIMES, *supra* note 5, at 302-03.

135. See Wolfenbarger & Gilly, *supra* note 6, at 41 (discussing how shoppers who shop online experience “convenience, informativeness” and value the “freedom and control” they experience shopping online); see also Note, *supra* note 4, at 1610-19 (noting how the Internet has changed competition in several ways).

136. U.S. CENSUS BUREAU, *supra* note 9, at 3.

137. *Id.*

138. *Id.*

139. See Note, *supra* note 4, at 1612-13.

140. See Wolfenbarger & Gilly, *supra* note 6, at 42.

141. See *id.* at 41 (listing several reasons why consumers shop online).

142. See Note, *supra* note 4, at 1612-13 (noting that “[p]rices at purely online retailers tend to be lower than Internet prices available at retailers using a combination of online and brick-and-mortar sales,” and noting that the Internet makes price competition more “salient”); see also Erik Brynjolfsson & Michael D. Smith, *Frictionless Commerce? A Comparison of Internet and Conventional Retailers*, 46-4 MGMT. SCI. 563, 563 (2000) (finding prices of books and CDs on the Internet are 9-16% lower than prices at conventional retailers).

143. Note, *supra* note 4, at 1614 (“[T]otal cost[s] for an online retailer may be lower because there is no need to invest in a physical storefront.”).

144. *Id.*

challenge local monopolies by providing customers with an alternative means of purchasing products.<sup>145</sup>

The Internet also increases price competition because customers can more easily compare prices among firms online.<sup>146</sup> Consumers often find information on products or services more readily available online, "information that previous to the Internet was either effortful or impossible to find."<sup>147</sup> Similarly, consumers' search costs are often lower online because they can search and compare products with a few clicks of a mouse.<sup>148</sup> The Internet also represents a unique buying experience that creates value for consumers. Consumers making a purchase online can do so from home<sup>149</sup> and without the hassle of dealing with sales people.<sup>150</sup> For instance, many consumers feel less "committed" to making a purchase online and derive value from this facet of online shopping.<sup>151</sup> Consumers who shop online often have different objectives<sup>152</sup>—while some are goal-oriented (for example, shopping online for convenience), others do so for fun.<sup>153</sup> Indeed, some consumers value the experience and fun of shopping online more than they value actually purchasing a product.<sup>154</sup> Examples of Internet retailers creating intertype competition can be

145. *Id.* at 1618; see Wolfinbarger & Gilly, *supra* note 6, at 41. Wolfinbarger and Gilly provide sample quotes from consumers as to why they shop online. *Id.* One in particular states, "I live in a very rural area. Other than a Wal-Mart and Kmart, my selection of physical stores is fairly limited. [I] have to drive over an hour to get to anything that resembles a real store." *Id.* Another stated, "Online is the world's stores in your face." *Id.*

146. Note, *supra* note 4, at 1612 (noting the "ease of price comparison on the Internet").

147. Wolfinbarger & Gilly, *supra* note 6, at 43.

148. *Id.* at 42 ("[W]eb-based purchasing is the ultimate in time savings, effort savings, and accessibility.").

149. *Id.*

150. *Id.* at 45 ("[S]alespeople are often perceived to be unhelpful or uninformed and . . . they pressure or obligate buyers. Online buyers revel in the fact that they can avoid sales workers online.").

151. *Id.* at 39-40.

152. See *id.* at 36 (describing and comparing two groups of online shoppers, those who are goal-directed and those who shop online for the experience). Compare *id.* at 41 tbl.4 (describing characteristics associated with goal-oriented shoppers), with *id.* at 47 tbl.6 (describing the characteristics associated with experiential shopping).

153. See *id.* at 46-48 (describing customers who shop online for fun); *Id.* at 47 tbl.6 (describing the characteristics associated with experiential shopping).

154. *Id.* at 36.

found in industries as diverse as books,<sup>155</sup> compact discs,<sup>156</sup> used cars,<sup>157</sup> cigarettes,<sup>158</sup> and contact lenses.<sup>159</sup>

### *B. Resale Price Maintenance Can Inhibit Intertype Competition*

Resale price maintenance policies can harm intertype competition by making Internet retailers less competitive. These policies eliminate price competition among retailers selling the same brand.<sup>160</sup> If online retailers compete with traditional retailers by offering lower prices, RPM agreements can make online retailers less competitive.<sup>161</sup> This reduces intertype competition.

Resale price maintenance policies can also make it more difficult for online retailers to enter markets and obtain market share by offering lower prices.<sup>162</sup> However, “[p]reserving entry opportunities for new retailers and new retailing approaches is a critical component to the dynamic growth of [the] economy.”<sup>163</sup> With an RPM agreement in place, Internet retailers may be deterred from entering the market because they cannot undercut the prices of incumbent firms, a move which is likely to be necessary to gain market share.<sup>164</sup> Not surprisingly, the ability to discount products in order to draw consumers is one of the new entrant’s “most potent competitive

155. See Brynjolfsson & Smith, *supra* note 142, at 563.

156. *Id.*

157. Fiona Scott Morton, Florian Zettelmeyer & Jorge Silva-Risso, *Internet Car Retailing*, 49-4 J. INDUS. ECON. 501, 501 (2001) (discussing the sales on used cars online).

158. John H. Knowles, Jr., Kay L. Wanke & Ichiro Kawachi, *Internet Sales of Tobacco: Heading off the New E-pidemic*, 25-2 J. PUB. HEALTH POL’Y 162 (2004).

159. James C. Cooper, *Prices and Price Dispersion in Online and Offline Markets for Contact Lenses 2* (FTC Bureau of Econ., Working Paper No. 283, 2006).

160. *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2715 (2007) (noting that vertical price restraints—for example, resale price maintenance—tend to eliminate intrabrand price competition); see SULLIVAN & GRIMES, *supra* note 5, at 315 (“[D]istribution restraints surely do raise consumer prices in most instances.”).

161. See SULLIVAN & GRIMES, *supra* note 5, at 314-15.

162. See *id.* at 303 (stating that the ability to discount items to draw consumers is “one of the new entrant’s most potent competitive tools”). Resale price maintenance policies prevent retailers, including potential entrants, from reducing prices. See *supra* text accompanying notes 23-27 (defining resale-price agreements as agreements that require retailers to charge a specific price).

163. SULLIVAN & GRIMES, *supra* note 5, at 303.

164. See *id.* (noting that intrabrand competition preserves a new entrant’s ability to enter markets and charge a lower price); *Leegin*, 127 S. Ct. at 2715 (stating that resale price agreements reduce intrabrand competition).

tools.”<sup>165</sup> In some cases, dominant traditional retailers could abuse RPM policies to deter entry by Internet retailers.<sup>166</sup>

Moreover, as the Supreme Court warned in *Leegin*, a dominant retailer could use an RPM policy to forestall innovation.<sup>167</sup> For example, a dominant retailer might use its buying power to coerce manufacturers to enter into RPM agreements that would set prices so high that lower-cost competitors, like Internet retailers, would not be able to enter the market and challenge its position.<sup>168</sup> In many cases, however, this will require that the retailer possess market power.<sup>169</sup>

The unique features of online retailing and the Internet make it more difficult to evaluate the competitive effects of RPM agreements. The traditional justifications for RPM agreements are that they induce retailers to provide point-of-sale services, which increase demand, and that they can eliminate free riding.<sup>170</sup> The Supreme Court relied primarily on these justifications in *Leegin* when it concluded that resale price agreements should be judged under the rule of reason.<sup>171</sup> Courts applying the rule of reason will likely look to these traditional justifications when evaluating RPM agreements.<sup>172</sup> Online retailers, however, may react differently to RPM agreements than the standard justifications indicate.<sup>173</sup>

The fact that commercial transactions are occurring on the Internet also makes it harder for courts to determine whether free riding is taking place.<sup>174</sup> The reality of online retailing does not necessarily invalidate the traditional justifications supporting RPM,

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165. SULLIVAN & GRIMES, *supra* note 5, at 303.

166. *Leegin*, 127 S. Ct. at 2717 (“[A] dominant retailer . . . might request resale price maintenance to forestall innovation in distribution that decreases costs.”); Note, *supra* note 4, at 1619 (“[B]usinesses are more likely to want to use [resale price maintenance agreements] given the Internet . . .”).

167. *Leegin*, 127 S. Ct. at 2717.

168. *See id.*

169. *Id.* at 2720 (noting that it is not a serious concern if a dominant retailer abuses resale price maintenance if the retailer does not have market power).

170. *See* HOVENKAMP, FEDERAL ANTITRUST, *supra* note 71, at 450-56 (discussing the free-rider problem and also offering some other reasons why resale price maintenance is used); LANDSBURG, *supra* note 74, at 381 (discussing why resale price maintenance can be economically efficient).

171. *Leegin*, 127 S. Ct. at 2715-16 (describing the procompetitive benefits of resale price maintenance). Resale price maintenance can also be used by a burgeoning manufacturer who seeks to enter a market by encouraging retailers to carry its brands. *Id.* at 2716.

172. *See id.* at 2715-17 (explaining how resale price maintenance can create procompetitive benefits such as eliminating free riding and encouraging retailers to provide point-of-sale services).

173. *See infra* text accompanying notes 175-92.

174. *See infra* text accompanying notes 193-98.

but it does make analyzing these types of agreements more complicated. In order to improve their analysis of RPM agreements, the Supreme Court should have instructed lower courts to consider intertype competition when applying the rule of reason.

1. Firms Selling Online May Not Respond to a Resale Price Maintenance Agreement by Improving Point-of-Sale Services

One of the traditional justifications supporting RPM is that by eliminating price competition, retailers will compete among one another by offering better point-of-sale services to promote the same product.<sup>175</sup> Online retailers, though, may not respond to RPM agreements by offering better point-of-sale services for two reasons: physical limitations and customer preferences.<sup>176</sup> The traditional argument that RPM agreements can increase point-of-sale services fails to take into account the fact that a firm selling online, in many cases, cannot possibly offer the same point-of-sale services as a brick-and-mortar firm. And even if it could, customers who buy online may not value point-of-sale services enough to offset the price increase caused by the RPM agreement.<sup>177</sup> Thus, RPM agreements may increase prices without inducing the positive effect of stimulating point-of-sale competition among Internet retailers.

In many instances, online sellers cannot offer the same point-of-sale services as brick-and-mortar firms because of physical limitations.<sup>178</sup> In such a situation, an RPM agreement may lead online sellers to charge higher prices with no corresponding increase in demand for a product.<sup>179</sup> Without an increase in demand, the RPM

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175. *Leegin*, 127 S. Ct. at 2715-16; see LANDSBURG, *supra* note 74, at 380-82 (explaining how resale price maintenance induces retailers to provide these services).

176. See *infra* text accompanying notes 183-85.

177. See *infra* text accompanying notes 181-92.

178. An online retailer would not be able to hire a friendly and knowledgeable sales staff in order to help sell products in the same way that, say, a used car dealer could do so. Generally, online sales people do not meet face-to-face with customers and usually only speak with customers when customers have a customer-service question. See, e.g., HERBERT HOVENKAMP, *ECONOMICS AND FEDERAL ANTITRUST LAW* 252-53 (1985) (using an auto dealership as an example of how sales staff works to help sell products) [hereinafter HOVENKAMP, *ECONOMICS*]. But see Wolfinbarger & Gilly, *supra* note 6, at 45-46 (discussing how email assistance and call centers can provide a way for customers to speak to sales people). Note that an RPM agreement could be used by a high-end manufacturer to ensure that its image as a luxury brand is not eroded by lower-priced retailers selling its products. See Note, *supra* note 4, at 1611 (discussing how brand image is one way that firms may try to differentiate themselves). The foregoing arguments do not apply to such a situation.

179. LANDSBURG, *supra* note 74, at 381 exhibit 11.4 (illustrating the need for the demand curve to shift up in response to a resale price maintenance agreement). If demand



agreement will cause online retailers to lose sales.<sup>180</sup> This effect harms intertype competition.

For instance, suppose a manufacturer implements an RPM policy that raises prices by 10 percent. The traditional justification for an RPM agreement indicates that firms will increase point-of-sale services, which will in turn boost demand.<sup>181</sup> A conventional retailer might improve point-of-sale services by, for example, hiring friendlier and more knowledgeable sales staff or creating new product displays.<sup>182</sup> In order for demand to increase, consumers must value these point-of-sale services.<sup>183</sup>

Because a firm selling online does not have a physical storefront, it may not be able to offer similar point-of-sale services. As a result, an Internet retailer may have to look for other ways to improve point-of-sale services in order to spark customer demand. Perhaps it could improve its website design or lengthen its warranty program.<sup>184</sup> Whether customers value these services enough to justify the increase in price would depend on the particular product and customer.<sup>185</sup>

In some circumstances, customers who buy online may not value point-of sale services enough to justify an increase in the price of a product.<sup>186</sup> Consumers in the online marketplace often have different preferences and goals than consumers purchasing from

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does not increase, then sales will decrease as a result of the higher price under the resale price maintenance agreement. *Id.*

180. *Id.*

181. *Id.* (illustrating and describing how demand increases as a result of the point-of-sale services provided); *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2715 (stating that resale price maintenance “encourages retailers to invest in tangible or intangible services or promotional efforts”).

182. See HOVENKAMP, *ECONOMICS*, *supra* note 178, at 252-53 (using car sales as an example of how sales staff help make sales).

183. LANDSBURG, *supra* note 74, at 381 exhibit 11.4 (showing that point-of-sale service must increase demand to justify the additional costs that retailers must incur to provide these services). The cost that retailers will incur to provide point-of-sale services equals the difference between marginal cost and the price set by the resale price maintenance policy. *Id.*

184. There are many ways in which an Internet retailer could provide better point-of-sale services. See iTunes Store - Wikipedia, [http://en.wikipedia.org/wiki/iTunes\\_Store#](http://en.wikipedia.org/wiki/iTunes_Store#) (last visited Jan. 19, 2008) (describing numerous promotional activities undertaken by iTunes).

185. See LANDSBURG, *supra* note 74, at 381 exhibit 11.4 (illustrating how demand increases by an amount, *V*, which is the value consumers place on the additional point-of-sale services).

186. *Id.* If consumers do not value the additional services then demand will not increase and sales will decrease. *Id.*; see also Wolfenbarger & Gilly, *supra* note 6, at 44-45 (explaining some of the reasons that consumers often prefer to shop online, including better information and the ability to avoid sales people).

traditional retailers.<sup>187</sup> Consumers who purchase online often place value on the unique attributes of using the Internet to make purchases.<sup>188</sup> Because consumers who purchase online may have different preferences and goals, a retailer who sells online likely faces a different demand curve than its brick-and-mortar counterpart selling the same product.<sup>189</sup> Because Internet retailers often face a different demand curve, it is unclear whether demand would expand enough in response to better point-of-sale services to offset the increase in price.<sup>190</sup> The traditional rationale for an RPM agreement assumes that retailers face essentially the same demand curve, which reacts in response to the additional or improved point-of-sale services.<sup>191</sup> Therefore, an RPM policy that applies to Internet retailers may not benefit online consumers since they may not value an improvement in point-of-sale services as much as consumers shopping at conventional retail outlets.<sup>192</sup>

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187. Wolfenbarger & Gilly, *supra* note 6, at 36 tbl.1 (summarizing reasons why consumers shop online, including accessibility, information availability, fun, and lack of presence of sociality). Consumers also choose to shop online because they feel less committed to making a purchase. *Id.* at 39.

188. See *id.* at 38-40 (explaining that some online shoppers are goal-oriented and enjoy the increased freedom and control they achieve online); *id.* at 40 tbl.3 (illustrating quotes taken from a focus group of online shoppers, including statements such as, "You can sit on your arse and eat while you shop. You can even shop naked!" and "You haven't driven over there and parked and walked around so you have a little more flexibility and can get around a lot faster"). Many consumers value the experience of shopping online. *Id.* at 46-48.

189. Some customers place a value on channel location, which means that some may prefer to purchase online, while others may still prefer to purchase in brick-and-mortar stores. See Wolfenbarger & Gilly, *supra* note 6, at 41 tbl.4 (describing why some consumers chose to purchase online).

190. See LANDSBURG, *supra* note 74, at 4 ("[A] change in anything other than price can lead to a change in demand") (emphasis omitted); *id.* at 381 exhibit 11.4 (illustrating that demand increases by the amount by which consumers value the additional services provided). Products online and offline are in essence substitutes for one another. See *id.* at 109.

191. See *id.* at 381 exhibit 11.4 (assuming that the demand curves facing retailers who sell the product are essentially the same).

192. Some shoppers are goal-oriented, and may simply be uninterested in fancy websites or product promotions. Wolfenbarger & Gilly, *supra* note 6, at 41 tbl.4. It is important to note that in many cases a manufacturer would be interested in how a resale price maintenance policy affects Internet retailers who distribute its products. If online retailers lose sales, the manufacturer also loses sales. However, because customer preferences differ across channels, Internet retailers could lose sales to brick-and-mortar stores, leaving manufacturers no worse off.

## 2. The Internet Makes it More Difficult to Determine Whether Free Riding is Taking Place

Another traditional justification for an RPM policy is that manufacturers can use the agreements to prevent free riding by competing retailers.<sup>193</sup> This justification also fails to take into account the changes brought about by the Internet distribution channel. The Internet may make it easier for firms to free ride.<sup>194</sup> But the Internet may also make it more difficult for courts to differentiate between free riding and legitimate competition because online firms may cater to the tastes of customers with different preferences, even while selling the same product as their brick-and-mortar counterparts.<sup>195</sup> If an online retailer is selling at a lower price, it does not necessarily mean that it is free riding on the point-of-sale services provided by brick-and-mortar firms.<sup>196</sup> An online retailer may serve a distinct market of customers who do not visit traditional retailers in order to take advantage of the traditional retailers' point-of-sale services.<sup>197</sup> For instance, a consumer purchasing music may have no reason to travel to a traditional retailer to learn about a particular artist or title; he or she may simply prefer to learn about the music and listen to sample tracks online.<sup>198</sup> Therefore, the Internet creates difficulties for courts attempting to discern whether free riding is taking place because Internet retailers may actually be serving distinct markets.

## 3. Intertype Competition Better Defines the Changes Brought About by the Internet Distribution Channel

In *Leegin*, the Supreme Court focused on the traditional justifications for RPM, such as its ability to induce retailers to provide

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193. *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2715-16 (2007) (describing what free riding is and explaining how resale price maintenance can eliminate free riding); HOVENKAMP, *FEDERAL ANTITRUST*, *supra* note 71, at 450-53.

194. Note, *supra* note 4, at 1615 (discussing free riding among different retailing channels).

195. See *infra* text accompanying notes 197-98 (discussing how consumers in different channels often have different preferences).

196. Note, *supra* note 4, at 1616 (noting that one out of four people who bought online may have been free riders on the services provided by brick-and-mortar retailers).

197. See *Wolfenbarger & Gilly*, *supra* note 6, at 41 (describing all of the reasons that goal-oriented shoppers purchased online).

198. See, e.g., iTunes Store - Wikipedia, *supra* note 184 (noting that users can preview songs for thirty seconds and TV and video for ninety seconds); accord *Wolfenbarger & Gilly*, *supra* note 6, at 43-44 (explaining how many consumers shop online because they find information on products and price more plentiful).

better point-of-sale services and reduce free riding.<sup>199</sup> These traditional justifications are centered on the premise that because RPM policies increase interbrand competition, while decreasing intrabrand competition, they are good for consumers.<sup>200</sup> Courts will likely look to these traditional justifications when applying the rule of reason to RPM agreements.<sup>201</sup>

The terms “interbrand” and “intrabrand” competition, however, do not describe the features of the modern marketplace brought about by the Internet distribution channel. By focusing on RPM agreements solely through the lens of intrabrand and interbrand competition, courts may not adequately consider the changes resulting from the development and growth of online retailing. Interbrand competition—the competition between firms selling different brands but similar products—does not adequately describe firms who are selling the same brand in different distribution channels, such as the Internet.<sup>202</sup> Intrabrand competition—generally describes vertical competition between firms in the same distribution channel selling the same brand—comes closer, but fails to encompass the extent to which different demand curves may accompany the same physical products in different distribution channels.<sup>203</sup> The term “intertype competition” better defines the competition between different types of firms as well as firms selling the same brand in different channels. With Internet retailers, this difference is the result of selling products online, which represents a substantially different means of selling products than traditional brick-and-mortar firms.

The Supreme Court should have instructed lower courts to consider the effects that RPM agreements have on intertype competition. The market place has changed substantially as a result of the Internet, and the Internet has invigorated intertype competition.<sup>204</sup> Each year billions of dollars of merchandise is sold online.<sup>205</sup> Resale price maintenance agreements can harm intertype competition, and as a result intertype competition is worthy of a court’s consideration when determining whether an RPM agreement is

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199. *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2715-16 (2007).

200. *Id.* at 2715.

201. *See id.* at 2715-17 (discussing how resale price maintenance can create procompetitive effects).

202. *See GAVIL, KOVACIC & BAKER, supra* note 17, at 342 fig.4-3 (illustrating interbrand competition).

203. *Id.* at 341 fig.4-2 (explaining the definition of intrabrand competition).

204. *See supra* text accompanying notes 135-59.

205. *See supra* text accompanying notes 136-39.

illegal in any particular case.<sup>206</sup> Moreover, the standard justifications for RPM agreements—that these agreements increases point-of-sale services and can prevent free riding—fail to take into account the Internet distribution channel.<sup>207</sup> If courts considered intertype competition, it is less likely that they would overlook the harmful and anticompetitive effects that RPM agreements may have on Internet retailers.

Although the Supreme Court did not instruct lower courts to consider intertype competition in their analyses of the illegality of RPM agreements under the Sherman Act, the Court did provide some relevant factors for lower courts to consider, which will in many instances prevent substantial harm to intertype competition.<sup>208</sup> One relevant factor is whether a large portion of manufacturers use RPM policies because it is unlikely that RPM is being used to support a cartel if only a few manufacturers have RPM policies.<sup>209</sup> The Court also instructed lower courts to consider whether a manufacturer or a retailer was the impetus behind such an agreement since there is more reason to be concerned that anticompetitive conduct is occurring if retailers are supporting such a policy.<sup>210</sup> Furthermore, the Court stated that unless a manufacturer or retailer has market power it is unlikely that an RPM policy is being abused for anticompetitive purposes.<sup>211</sup> In many cases, these factors should help the lower courts prevent RPM agreements from being used to produce anticompetitive effects.

Nevertheless, the Supreme Court should have instructed lower courts to consider intertype competition so that courts will focus on the effects that RPM agreements have on Internet retailers. The purpose of antitrust law is to protect competition, not competitors.<sup>212</sup> On an individual level, Internet retailers are simply competitors. But *en masse*, Internet retailers create intertype competition, which is worthy of the courts' consideration when evaluating competition in the marketplace. Therefore, by considering intertype competition as a distinct form of competition that is worthy of protection under the rule of reason, courts would more accurately assess the competitive effects that RPM agreements have on competition generally.

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206. See *supra* text accompanying notes 160-74.

207. See *supra* text accompanying notes 170-98.

208. See *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705, 2719-20 (2007).

209. *Id.*

210. *Id.*

211. *Id.* at 2720.

212. *Id.* at 2724.

## IV. CONCLUSION

The Supreme Court should have instructed lower courts to consider intertype competition in addition to interbrand and intrabrand competition when evaluating RPM agreements under the rule of reason. The Internet has invigorated intertype competition and made it an important competitive force in the economy. Resale price maintenance agreements have the potential to harm intertype competition. Moreover, the growth of online retailing has challenged the traditional justifications that support RPM policies. Online retailers may not react to an RPM agreement in the same way as traditional retailers, and the existence of online retailers now makes it more difficult for courts to determine whether an RPM agreement may be necessary for a manufacturer to prevent free riding. Courts should consider intertype competition when applying the rule of reason to resale price agreements to more accurately and fairly assess the competitive effects of these agreements.

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